



Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
Telecommunications Device for the Deaf - (916) 795-3240
(916) 795-3400

August 18, 2008

AGENDA ITEM 9a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Environmental Manager Annual Review
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Renew the contracts of CalPERS' five external environmental equity managers listed below for a period of one year. Wilshire Associates' opinion letter and disclosure letter are shown in Attachments 1 and 2.

Domestic Environmental External Equity Managers

AXA Rosenberg Investment Management
New Amsterdam Partners
State Street Global Advisors

International Developed Markets Environmental External Equity Managers

Brandywine Global Investment Management
State Street Global Advisors

IV. ANALYSIS:

Executive Summary

The performance of the entire environmental external equity manager program for the fiscal year ending June 30, 2008 was -9.58%. This program performance was 1.26% above the benchmark. Current assets in this program are \$493.9 million.

Background

At its April 19, 2004 meeting, the Investment Committee considered environmental investing strategies, including environmentally screened public equity funds performing as well or better than their non-screened counterparts. Specifically targeted were stock portfolios in environmentally screened funds managed by leading active public equity investment managers with proven track records. At

this meeting the Investment Committee voted to allow staff, in its discretion, to either: (1) hire external managers for up to \$500 million total, (2) allocate up to \$500 million to mutual funds that have good records, or (3) a combination thereof, to achieve the best results for the System.

Mutual funds were considered first with a Request for Information (RFI) issued in September 2004. On April 1, 2005, CalPERS invested in BGI's iShares KLD Select Social Index Fund, an Exchange Traded Fund (ETF). On May 13, 2005, a Request for Proposal (RFP) was issued to firms identified through the prior RFI search. The RFP was advertised in *Pensions and Investments* and the *Financial Times*.

Five firms and six products were recommended to and approved by the Investment Committee at its November 14, 2005 meeting, creating a pool to which additional products may be added in the future. CalPERS contracted with and funded five products over the period February 1, 2006 to June 1, 2006. After engaging and funding the five products mentioned above, the investment in BGI's iShares KLD Select Social Index Fund was liquidated. The last month of performance for this product was July 2006.

At the April 2007 Investment Committee meeting, the Global Equity delegation for environmental managers was changed from \$500 million to a range of 0% - 0.5% of Global Equity, or about \$600 million currently.

All of the managers have one year renewable contracts contingent upon the Investment Committee's annual approval. Each contract also contains a provision allowing for termination upon 30 days' notice.

Assets under Management

As of June 30, 2008, total assets under management by the external environmental managers were \$493.9 million. Table 1 shows the assets managed by each manager as of this date.

Table 1

Manager	Mandate	Portfolio Value (millions)	Portfolio Percent
Domestic Managers		\$290.5	58.8%
AXA Rosenberg Investment Mgmt.	U.S.	\$133.2	27.0%
New Amsterdam Partners	U.S.	\$79.2	16.0%
State Street Global Advisors	U.S.	\$78.1	15.8%
International Managers		\$203.4	41.2%
Brandywine Global Inv. Mgmt.	Dev ex-U.S.	\$78.2	15.8%
State Street Global Advisors	Dev ex-U.S.	\$125.2	25.4%
Total External Environmental Equity		\$493.9	100.0%

Source: State Street Bank

Program Performance

The performance objective of all environmental portfolios is to exceed the benchmark returns, net of management fees, over a full market cycle, considered to be three to five years.

Over the 2007/2008 fiscal year, the CalPERS Environmental External Equity portfolio in aggregate outperformed the custom benchmark by 1.26%. All returns in this report are net of management fees and are CFA Institute compliant.

Table 2 illustrates each manager's performance relative to its respective benchmark since the initial funding date.

Table 2

Environmental External Equity Relative Performance	Fiscal* Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception	IR**	Inception Date
Domestic Managers						
AXA Rosenberg	(0.80)%	(0.84)%	3.79%	1.24%	0.32	4/1/06
New Amsterdam Partners	(2.76)%	(5.37)%	6.14%	(0.25)%	(0.06)	2/1/06
State Street Global Advisors	0.19%	(0.73)%	(0.26)%	(0.34)%	(0.13)	6/1/06
International Managers						
Brandywine	(2.10)%	(0.44)%	(4.67)%	(3.73)%	(1.09)	5/1/06
State Street Global Advisors	1.64%	4.03%	0.90%	2.67%	0.94	3/1/06
Total Environmental	(1.27)%	(0.77)%	1.26%	(0.21)%		2/1/06

Source: State Street Bank Returns are net of fees and CFA compliant.

*Note FY 05/06 was a partial year beginning February 1, 2006.

**Note the information ratios may not be meaningful as the program does not have 36 months of data.

As noted in Table 2 above, Brandywine, an international manager with a value style, had a particularly difficult year and has struggled over its 26 month history with CalPERS. Staff and Wilshire continue to closely monitor this manager's performance relative to its benchmark and other managers with a similar style bias.

The following two charts illustrate the program profile as of June 30, 2008. Chart 1 plots performance, by six month periods, of the total program and its benchmark, as well as the cumulative active return since inception.

Chart 2 plots the risk/return profile of each of the managers and the total program, using active return and tracking error. The size of the bubbles reflects the proportion of assets in each portfolio as of June 30, 2008.

Chart 1

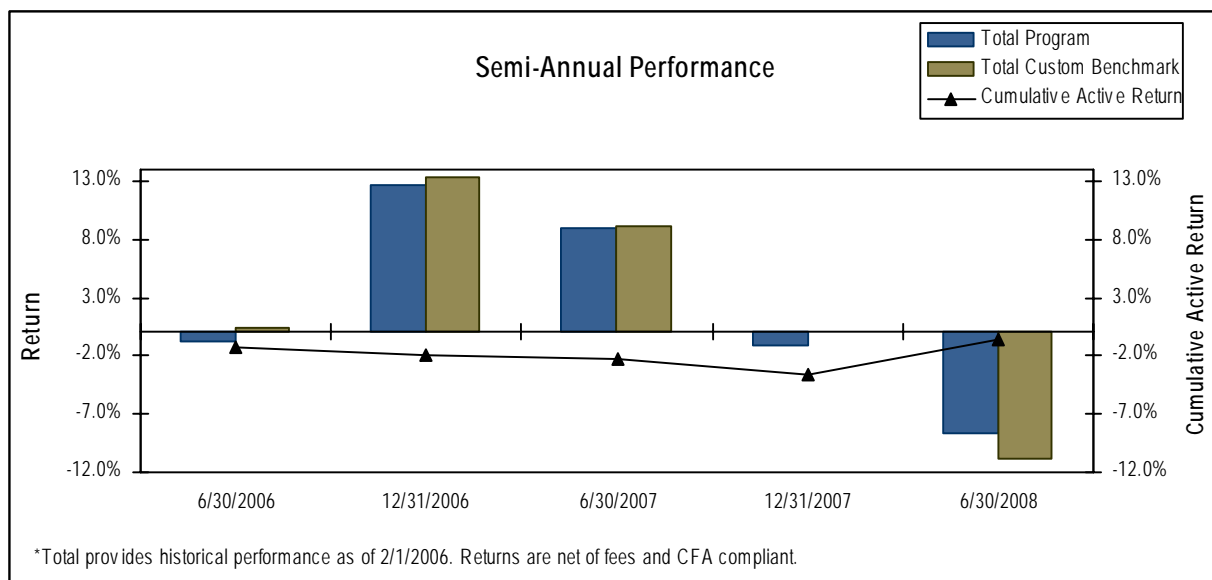
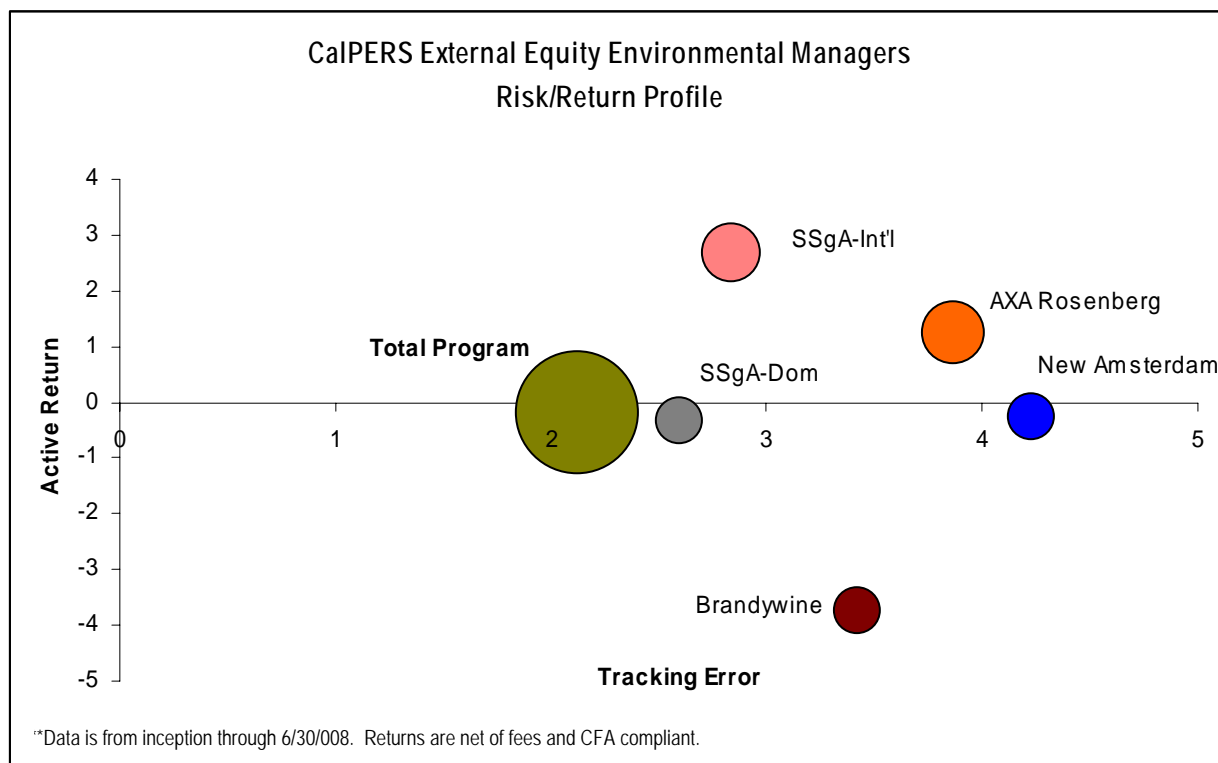


Chart 2



The managers currently in CalPERS' environmental program also run these portfolios using the same or similar processes without the environmental overlay. Table 3 below contrasts the performance of the CalPERS environmental portfolios against the managers' unconstrained composites from the inception of each CalPERS portfolio through June 30, 2008. Because the managers' composite data is gross of fees, in this chart only, CalPERS' environmental manager performance is shown gross of fees.

As can be seen in Table 3, there can be a wide variation in results. Over this time period, two of the five managers' environmental strategy outperformed their unconstrained strategy composite.

Table 3

Manager	CalPERS Environmental Performance	Unconstrained Portfolio Performance	Difference	Inception Date
Axa Rosenberg	2.90%	4.14%	(1.24%)	4/1/06
New Amsterdam	1.99%	(0.17%)	2.16%	2/1/06
SSgA – Domestic	1.88%	5.32%	(3.44%)	6/1/06
Brandywine	2.13%	3.98%	(1.85%)	5/1/06
SSgA - International	11.67%	7.35%	4.32%	3/1/06

*All returns are shown gross of management fees.

Individual Manager's Performance and Evaluation

The following section of the agenda item contains a one page write-up for each manager in the environmental program.

AXA Rosenberg Investment Management (Domestic)

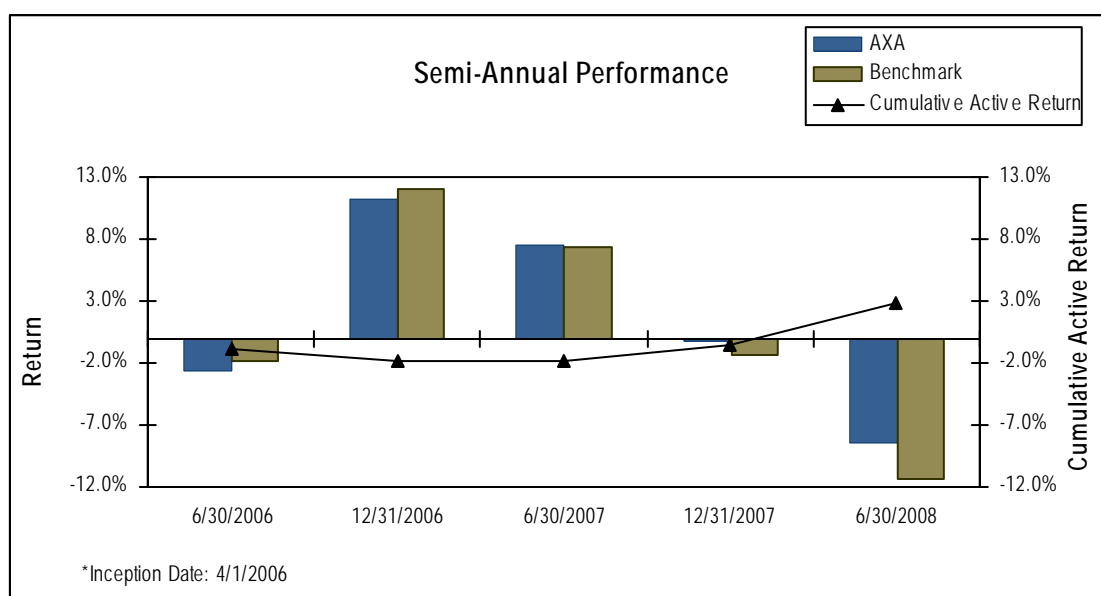
AXA was funded on April 1, 2006. This manager's stock selection process includes two fundamental insights. A valuation model identifies bargains and expensive stocks within each industry. An earnings forecast model identifies companies with superior/inferior year-ahead earnings. AXA receives a list of restricted companies from the Investor Responsibility Research Center (IRRC) based on federal environmental law violations, regulatory problems, and substantial emissions, spills and releases. These stocks are removed from the investment universe. The portfolio typically holds 200-250 stocks.

For the fiscal year ending June 30, 2008, AXA outperformed the benchmark by 3.79%. The excess return was driven by the portfolio's overweight in the energy sector, as well as stock selection within the energy, information technology, and materials sectors. From inception, AXA has outperformed its benchmark by 1.24% on an annualized basis. Assets under management as of June 30, 2008 were \$133.2 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
AXA	(2.57%)	19.54%	- 8.67%	2.79%
Benchmark	(1.77%)	20.38%	-12.46%	1.55%
Active Return	(0.80%)	(0.84%)	3.79%	1.24%

*Inception Date 4/1/06 Source: State Street Bank Returns are net of fees and CFA compliant.

The chart below shows AXA's performance versus its benchmark. The axis on the left measures the manager's semi-annual performance against its benchmark. The right axis measures AXA's cumulative performance relative to the benchmark.



New Amsterdam Partners (Domestic)

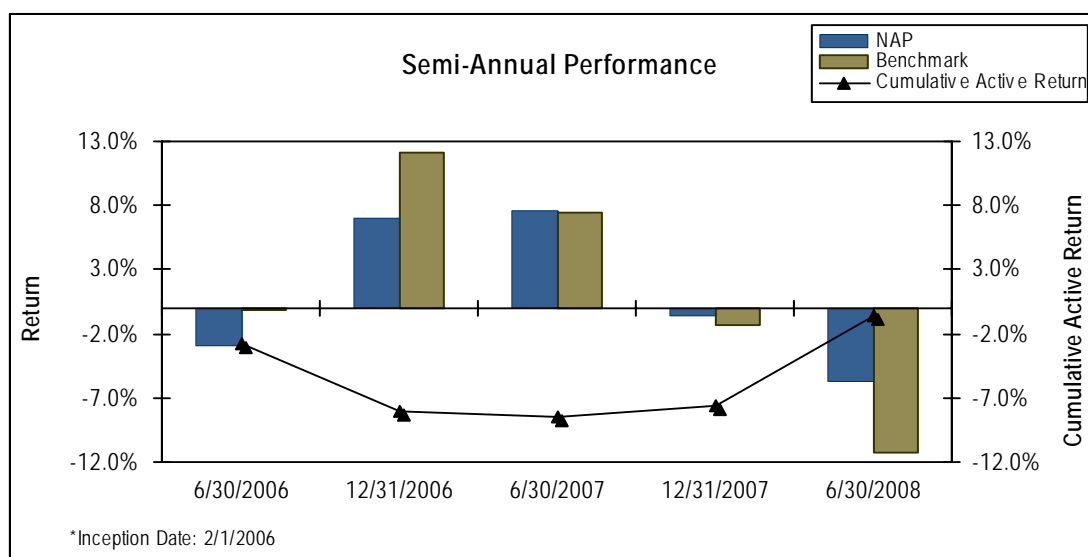
New Amsterdam Partners was funded on February 1, 2006. This manager's blend of quantitative and fundamental research identifies mispriced securities with better than average forecast growth and profitability. Companies' environmental and social responsibility records are examined carefully by the firm's analysts. The objective is to build a portfolio that will outperform the market, while being environmentally and socially responsible. The portfolio typically holds 40-45 stocks.

For the fiscal year ending June 30, 2008, New Amsterdam outperformed the benchmark by 6.14%. New Amsterdam benefited as the market reversed this year in terms of rewarding growth-oriented styles rather than value. This manager's underweighting in financials significantly contributed to its outperformance. Stock selection in the energy, health care, materials, and industrials sectors also contributed. From inception, New Amsterdam has underperformed its benchmark by 25 basis points on an annualized basis. Assets under management as of June 30, 2008 were \$79.2 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
NAP	(2.99%)	15.01%	(6.32%)	1.85%
Benchmark	(0.23%)	20.38%	(12.46%)	2.10%
Active Return	(2.76%)	(5.37%)	6.14%	(0.25%)

*Inception Date 2/1/06 Source: State Street Bank Returns are net of fees and CFA compliant.

The chart below shows New Amsterdam's performance versus the benchmark. The axis on the left measures the manager's semi-annual performance against its benchmark. The right axis measures New Amsterdam's cumulative performance relative to the benchmark.



State Street Global Advisors (Domestic)

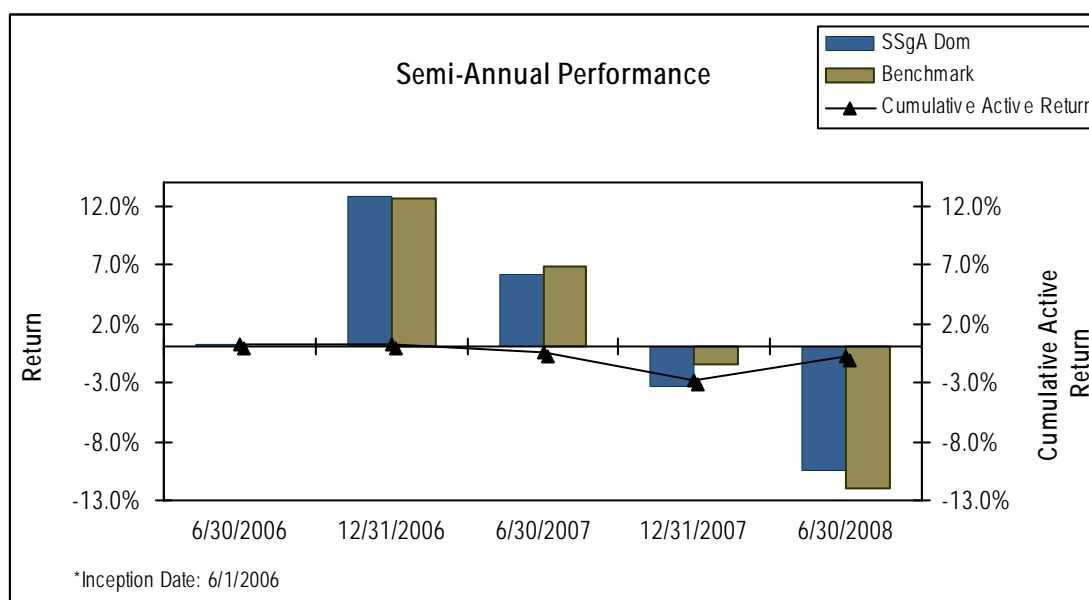
State Street Global Advisors (SSgA) was funded on June 1, 2006. This U.S. Core Environmental Strategy is quantitative, bottom-up, well-diversified, and consists of large cap securities, with reduced exposure to companies with poor eco-efficiency, using ranking provided by Innovest. The strategy is managed to have characteristics similar to the S&P 500 Index. The portfolio typically holds 70-150 stocks.

For the fiscal year ending June 30, 2008, SSgA underperformed the benchmark by 32 basis points. Stock selection in the financials sector contributed positively to this year's relative performance but stock selection within the healthcare and energy sectors detracted from relative performance. From inception, the SSgA domestic portfolio has underperformed its benchmark by 38 basis points on an annualized basis. Assets under management as of June 30, 2008 were \$78.1 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
SSgA-Dom	0.28%	19.66%	(13.54%)	1.79%
Benchmark	0.09%	20.39%	(13.28%)	2.13%
Active Return	0.19%	(0.73%)	(0.26%)	(0.34%)

*Inception Date 6/1/06 Source: State Street Bank Returns are net of fees and CFA compliant.

The chart below shows SSgA's performance versus its benchmark. The axis on the left measures the manager's semi-annual performance against its benchmark. The right axis measures SSgA's cumulative performance relative to the benchmark.



Brandywine Global Investment Management (International)

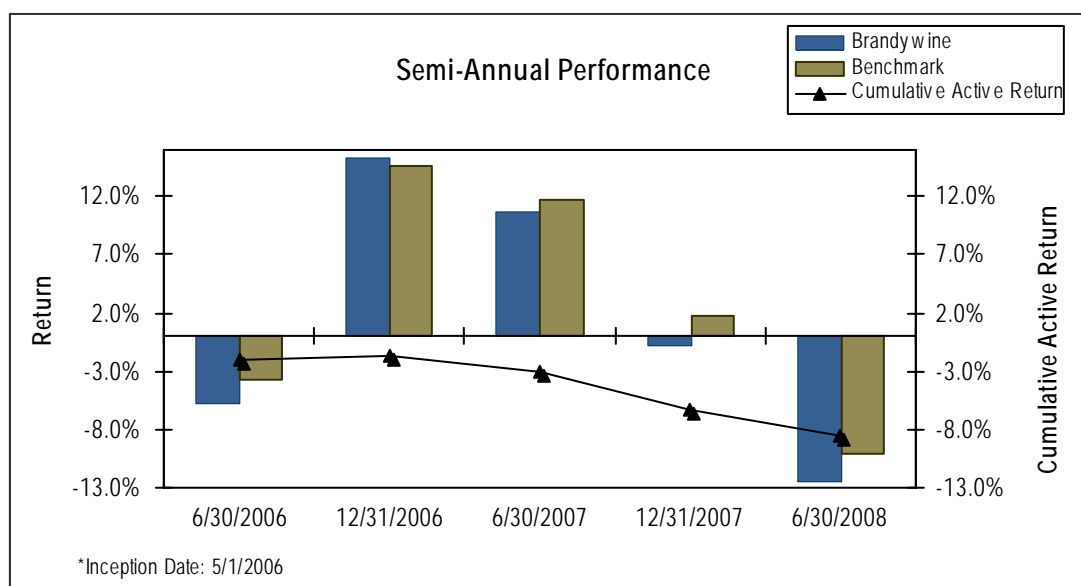
Brandywine was funded on May 1, 2006. This manager uses quantitative screening to select stocks that are trading below normal valuation. Fundamental research highlights firms that have the catalysts in place to spur a return to normal valuation. Brandywine excludes stocks with unfavorable ratings, supplied by Legg Mason Investment Counsel, based on: environmental awareness and footprint, stakeholder relations, location/industry specific issues, and evaluation of public perception. The portfolio typically holds 50-90 stocks.

For the fiscal year ending June 30, 2008, Brandywine underperformed the benchmark by 4.67%. While this manager has underperformed from inception, the past fiscal year was particularly difficult for value managers like Brandywine. Underperformance was due primarily to poor stock selection in the financials, materials, and information technology economic sectors, as well as an underweight in telecommunications. Assets under management as of June 30, 2008 were \$78.2 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
Brandywine	(5.83%)	27.62%	(13.14%)	2.00%
Benchmark	(3.73%)	28.06%	(8.47%)	5.73%
Active Return	(2.10%)	(0.44%)	(4.67%)	(3.73%)

*Inception Date 5/1/06 Source: State Street Bank Returns are net of fees and CFA compliant.

The chart below shows Brandywine's performance versus its benchmark. The left axis measures the manager's semi-annual performance against its benchmark. The right axis measures cumulative performance relative to the benchmark.



State Street Global Advisors (International)

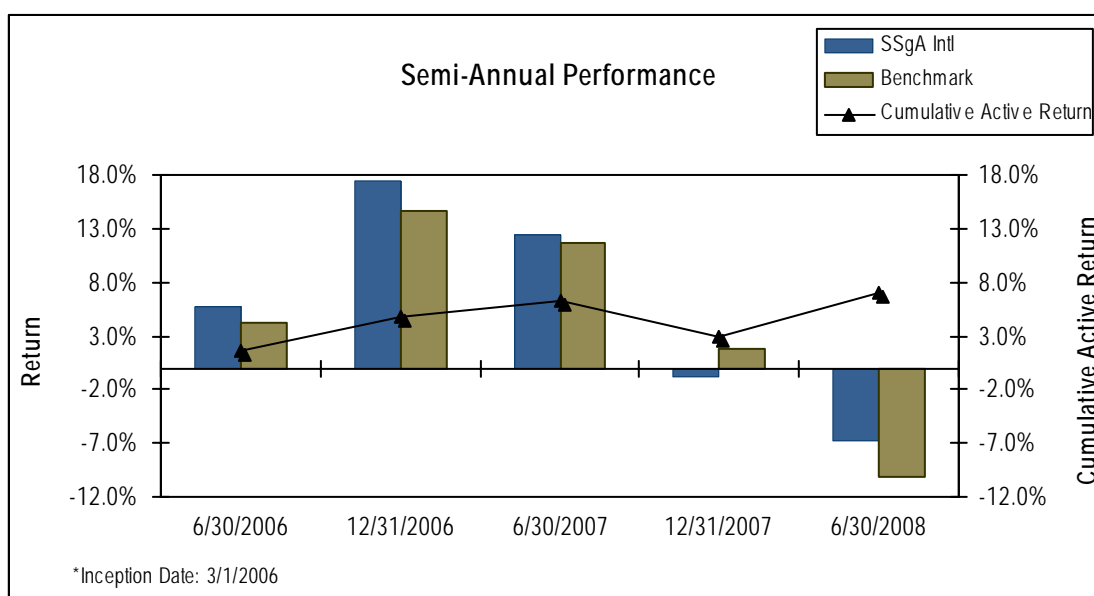
State Street Global Advisors (SSgA) was funded on March 1, 2006. SSgA's core non-U.S. equity stock selection approach is combined with environmental stock ratings supplied by Innovest. The process is a blend of quantitative analysis and qualitative assessments. Stocks are ranked according to factors that have been shown to identify mispricing: value, sentiment and earnings growth. Low-multiple stocks with improving earnings are favored and higher-multiple stocks with poor earnings prospects are avoided. The strategy is managed to have characteristics similar to the benchmark. The portfolio holds up to 150 stocks.

For the fiscal year ending June 30, 2008, SSgA outperformed the benchmark by 51 basis points. The portfolio benefited from good stock selection in the consumer discretionary, industrials, health care and consumer staples sectors. From inception, the SSgA international portfolio has outperformed its benchmark by 2.46%. Assets under management as of June 30, 2008 were \$125.2 million.

Manager	Fiscal Year 05/06	Fiscal Year 06/07	Fiscal Year 07/08	Annualized Since Inception*
SSgA-Intl	5.76%	32.09%	(7.57%)	11.58%
Benchmark	4.12%	28.06%	(8.47%)	8.91%
Active Return	1.64%	4.03%	0.90%	2.67%

*Inception Date 3/1/06 Source: State Street Bank Returns are net of fees and CFA compliant.

The chart below shows SSgA's performance versus its benchmark. The axis on the left measures the manager's semi-annual performance against its benchmark. The right axis measures SSgA's cumulative performance relative to the benchmark.



Next Steps

When CalPERS issued its Request for Proposal for Environmental Investing in May 2005, managers were asked to submit proposals for active U.S. equity management or active international equity management. The managers that were hired are, for the most part, managers that screen out firms based on environmental criteria.

As staff has continued to monitor the evolution of environmental investing, it seems clear that many managers choose to launch global equity products instead of U.S. only or non-U.S. only. In addition, staff believes there are now more opportunities to invest with managers who are targeting investments in companies that have an advantage in adapting to, or mitigating, climate change, rather than managers whose processes involve screening out companies. Therefore, staff believes that it would be worthwhile to conduct a new manager search some time in the coming fiscal year. Staff will prepare a separate agenda item on this topic for the Investment Committee's consideration at a future meeting.

In addition to external managers, staff is also looking at possible strategies that could be implemented internally. Whether staff recommends additional external or internal portfolios, it will likely be necessary to increase the Global Equity delegation to environmental strategies from the current 0% - 0.5% range. This issue will also be addressed in a future agenda item.

Recommendation

Staff recommends renewal of the contracts for all five environmental equity managers for a period of one year. Each contract contains a provision allowing for termination on 30 days' notice.

V. STRATEGIC PLANS:

External investment manager performance is monitored by staff and reported to the Investment Committee per CalPERS Strategic Plan, Goal VIII to manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

The purpose of this item is to keep the Investment Committee informed of the performance of the environmental external equity manager program.

Prepared By:

LaShae Howell
Investment Officer

Mary C. Cottrill
Senior Portfolio Manager

Eric Baggesen
Senior Investment Officer

Anne Stausboll
Interim Chief Investment Officer